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UNCLAS SECTION 01 OF 04 SHANGHAI 000248

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STATE FOR EAP/CM, DAS DAVIES
TREASURY FOR OASIA/INA -- DOHNER/HAARSAGER/WINSHIP
TREASURY FOR IMFP -- SOBEL/CUSHMAN
USDOC FOR ITA DAS KASOFF, MELCHER, MAC/OCEA
NSC FOR LOI, SHRIER
STATE PASS CEA FOR BLOCK
STATE PASS USTR FOR STRATFORD/WINTER/MCCARTIN/KATZ/MAIN
STATE PASS CFTC FOR OIA/GORLICK

E.O. 12958: N/A

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SUBJECT: (SBU) SHANGHAI EMPHASIZES ECONOMIC GROWTH TO KIRK, LARSEN

REF: SHANGHAI 191

¶1. (SBU) Summary. During a May 27-28 visit by U.S. Representatives Larsen and Kirk, a variety of interlocutors painted a picture of Shanghai responding to a sharp downturn in the local economy, but optimistic that the elements of longer-term growth are in place. AmCham Shanghai noted that multinationals now have to bring their "A team" to China in order to profit, and that the previous model of using China merely for low-cost labor assembly has become outdated. Shanghai is hungry for new technology, and in some cases is using regulatory measures to force technology transfer or to protect local industries in the process, said the AmCham Shanghai interlocutors. Shanghai officials met by the delegation said that Shanghai was seeking to lend a short-term stimulus to the economy, while simultaneously moving gradually towards a more sustainable, domestic consumption-led growth model. A senior Shanghai legislator outlined examples of the legislature impacting local policies. As for China's international economic policy, interlocutors said that China would place greater attention on the U.S. making "responsible" economic choices, and China will seek a greater voice in international financial institutions. End summary.

¶2. (U) U.S. Representative Rick Larsen (D-Washington) and U.S. Representative Mark Kirk (R-Illinois), Co-Chairs of the U.S.-China Working Group in the House of Representatives, led a delegation sponsored by the National Committee on United States-China Relations (NCUSCR) and the National People's Congress of the People's Republic of China on a May 27-28 visit to Shanghai to look at local trends in advanced manufacturing. The delegation included Steve Orlins, NCUSCR President. On May 28, the delegation held a roundtable of local businesses arranged by the U.S.-China Business Council and the American Chamber of Commerce, Shanghai; met with local business representative offices of their home constituencies; had lunch with Shanghai Municipal People's Congress (SMPC) Vice Chair Madame Yang Dinghua; met with Fang Xinghai, Director-General of the Shanghai Financial Services Office (SFSO); and held a roundtable with local academics on the topic "2011: What Will China's International Financial Role be Post-Crisis?"

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Shanghai Manufacturing Moving Up the Value-Added Chain

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13. (SBU) Ted Hornbein, Managing Director for Asia, Richco International Trading, and a member of the AmCham Shanghai committee studying trends in the local manufacturing sector, set the tone for the delegation's first meeting, saying that multinationals now have to bring their "A team" to China in order to profit. He said that the previous model of using China merely for low-cost labor assembly has been outdated by the combined pressures of the Labor Contract Law, exchange rate appreciation, and environmental restrictions, among other factors. In addition, the committee's study also identified companies manufacturing "in China, for China" as more successful. (Note: The China Manufacturing Competitiveness Study 2008-2009 is available on the AmCham Shanghai website. End note.) Jeff Song, President China, Ingersoll Rand, a manufacturer of industrial air chillers and other products, confirmed these trends, saying that his company starts out with only 20 percent local content, but eventually sources 70 percent locally. However, he added that fears of intellectual property theft and other factors contributed to the company always retaining some imports.

14. (SBU) Several representatives noted concerns about forced technology transfer or local protectionism. For instance, Charles McElwee, a lawyer with Squire, Sanders, and Dempsey's Shanghai office, said that local governments are requiring 70 percent local content for companies bidding for windpower projects. In addition, he said, there is an expectation among Chinese officials that advanced windpower technology will be

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compulsorily licensed at low profit margins to Chinese firms, and that this is one of the three central elements of Beijing's negotiating position heading into the upcoming Copenhagen talks on climate change. James McGill, President Asia Pacific, Eaton Corporation, a maker of hybrid engines for buses and other equipment, said that his company is close to closing a deal to provide dozens of green-technology buses for the 2010 Shanghai Expo, but that because Eaton uses Cummins engines built in Wuhan rather than SAIC engines built in Shanghai, some problems remain. (Note: McGill separately indicated to ConGenOffs that the decision not to move forward on the purchase had apparently risen to the level of Shanghai Executive Vice Mayor Yang Xiong. End note.) Mitch Barns, President for Nielson Greater China, said that the company a few weeks ago dropped its television ratings business in China because regulators had made it clear that CCTV's own ratings service was preferred, even though advertisers complain that programs are able to purchase higher ratings from CCTV.

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Shanghai Slowly Adapting to Global Financial Crisis

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15. (SBU) SMPC Vice Chairwoman Yang Dinghua at a reception and lunch for the delegation said that despite the difficult circumstances Shanghai faces as a result of the global financial crisis, the short-term stimulus measures introduced by the Central Government are having a positive impact, and, longer term, the city's economy is being gradually restructured. Yang noted that Shanghai is shifting away from manufacturing and towards services; in fact, services now accounts for 52 percent of the city's GDP, and this is expected to grow further this year. Industrial restructuring is one of Shanghai's major tasks this year, as is maintaining unemployment at a stable level below 4.5 percent. (Note: Yang was most likely referring to the official unemployment number, which does not count migrant workers and probably undercounts layoffs in the private sector. End note.)

16. (SBU) Yang said that, while Shanghai received little in

direct stimulus funding, the Central Government had recently approved two related measures that would help support Shanghai's growth: naming Shanghai as China's international financial center and international shipping center (see reftel) and arranging for Pudong District to absorb the neighboring Nanhui District. Yang explained the possible synergies opened up by these policies, including tapping Pudong's financial industry to develop the shipping industry and its associated financial service needs--including insurance and trade finance--while drawing on the undeveloped land in Nanhui to give Pudong growing room.

17. (SBU) SFSO's Fang Xinghai later emphasized a similar theme, that changes to China's financial structure would take time. Consumption is hard to increase in the short term, said Fang:

- the Chinese people are poor, and have an inadequate social safety net, so it is appropriate for them to save for necessities;
- for this same reason, further appreciation of the renminbi will not stimulate domestic consumption, because this will not put more money in poor people's pockets;
- in a similar way, lowering the savings rate also will not stimulate domestic consumption, as savings have come from the corporate sector, including exporters;
- even for people that do have money, there is a dearth of consumption goods in China, as with rich Shanghai people who tell Fang that there is not enough high-quality private education in the city.

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18. (SBU) Fang added his impression that Chinese economic decision makers would switch tracks from using banks to finance the bulk of China's stimulus, as currently is the case. First, banks are still at around a .75 : 1.00 loan-to-deposit ratio, but they are beginning to tell that government that they are unable to continue at the current lending growth rate. In addition, Chairman Liu Mingkang of the China Banking Regulatory Commission (CBRC) has been warning that the banks are taking on undue risk. For instance, said Fang, CBRC has recently reaffirmed the rule that people contribute a 40 percent down payment when taking out a second mortgage, a rule that was not being observed.

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Shanghai Legislature Exercising Its Oversight Powers

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19. (SBU) SMPC Vice Chairwoman Yang and Yuan Yining, who serves on the SMPC budget committee, offered the delegation some examples of oversight functions of the legislature. Yang noted that "the government needs to report" to the SMPC regarding "issues that are on the agenda of the SMPC." Yang and Yuan cited two cases where legislative oversight had resulted in policy changes. In one case, the government had allocated RMB1 billion (Note: Approximately US\$150 million. End note.) for energy savings and pollution reduction, but the funds had not been spent because there were no implementing regulations. There were "beautiful plans," said Yang, but no concrete procedures for carrying them out. The legislature asked the government to issue implementing regulations so that businesses could use the allotted funds. In a second case, said Yang, the government was offering a 150 percent tax rebate on businesses involved in creating products based on indigenous Chinese innovation. Again, the implementing policies were unclear so the rebates were going unclaimed, and the SMPC stepped in to ask for changes.

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China Developing Its Foreign Economic Policy

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¶10. (SBU) Fang said that People's Bank of China Chairman Zhou Xiaochuan issued his pre-G-20 paper calling for a dollar substitute in international trade to call attention to China's concern over the "irresponsible" way that the United States was handling its financial affairs. China realizes that it would be impossible to create a dollar substitute without the consent of the United States, and also that the United States would not agree to this change. At the same time, Fang agreed that China was working to reduce the average maturity of its official U.S. debt instruments. Beijing's promotion of the use of the renminbi in international trade is in part a reaction to the drying up of trade finance in the wake of the global financial crisis, said Fang. China should "aggressively push" for greater south-south trade denominated in renminbi, said Fang, including in countries such as Indonesia.

¶11. (SBU) At a subsequent academic roundtable, Professor Pan Rui of the Center for American Studies at Fudan University continued this theme, noting that more lesser developed countries are trying to learn from the "Beijing Consensus"--which Pan said entailed economic growth without Western-style democracy--in the wake of the global financial crisis, turning to China as their exemplar rather than the United States. China is set to gain political clout by maintaining its growth rate during the crisis, said Pan. With respect to what China expects from the United States, Pan invoked a phrase first used during the Bush Administration, that China be a responsible stakeholder in the international system. Now China wants to raise this same question with the United States, said Pan. If China is to continue to purchase large amounts of U.S. debt, China hopes that the United States will

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act in a "responsible" manner, which includes not weakening the U.S. dollar.

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China Seeking a Greater Role in IFIs
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¶12. (SBU) Pan also noted that China would gradually seek a greater voice in the international financial institutions, although it would probably seek to maintain its developing country status. One way to achieve both simultaneously, said Pan, was to work together with the BRIC countries (Note: Brazil, Russia, India, and China. End note.). Professor Frank Peng of Tongji University's World Bank Studies Center said that even if the large developing countries were to act more in concert, this would probably not lead to an end of the guiding influence of the developed countries, since at the World Bank, major rules changes require a 60 percent vote, and developed countries hold over 40 percent of the vote currently.

¶13. (U) The delegation did not have an opportunity to clear on this cable.
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